Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

Connect America Fund	)	WC Docket 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	))	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing a Unified Intercarrier Compensation Regime	))	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	))	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109

COMMENTS OF
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

Susan M. Gately
SMGately Consulting, LLC
84 Littles Ave,
Pembroke, MA 02359
(617) 598-2223

Economic Consultant

Colleen Boothby
Andrew M. Brown
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, NW, Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for Ad Hoc Telecommunications Users Committee

August 24, 2011

Table of Contents

SUMMARY

In response to the Commission's broad reform proposals in the NPRM initiating this docket, the wireline carriers have developed alternative "reform proposals." Not surprisingly, the Wireline Carrier Plans offer patently parochial, self-serving, and merely incremental changes to the USF system and ICC rules. They preserve USF funding for traditional wireline services and allow only limited amounts for alternative technologies such as wireless and satellite which are often more cost effective for broadband deployments in high cost areas. By subsidizing and facilitating incumbent carriers' continued control of last mile facilities, the Wireline Carrier Plans would impede the development of broadband competition for millions of Americans.

After delaying this rulemaking in anticipation of reasonable consensus proposals that have failed to materialize, the Commission must now redouble its efforts to adopt real and comprehensive USF/ICC reforms like those proposed in the NPRM. Now is not the time for the Commission to go wobbly in its commitment to undertake the reform of USF programs and ICC rules that is long overdue.

As Ad Hoc explains in greater detail below, the Wireline Carrier Plans contain numerous gaps and flaws:

- They contain no competitive mechanisms, such as reverse auctions, that would target subsidies more cost-effectively and reduce the overall size of the fund.

- They limit the distribution of nearly all future CAF dollars to incumbent LECs for use with wireline-only broadband services. But USF/CAF funding should be competitively neutral, technology agnostic, and support one provider per wire center.

- They rely on the CQBAT model, filed at the eleventh hour and without enough information for it to be independently verified.

The Commission should therefore reject the Wireline Carriers' Plans.

In reponse to the specific questions raised in the Public Notice, Ad Hoc urges the Commission to take the following steps:

- The Commission should adopt an 8.5 per cent interim rate of return, subject to a rebuttable presumption for carriers that can demonstrate the need for a higher figure, pending a more comprehensive rate of return analysis by the Commission.

- The Commission should implement its proposal to eliminate support for corporate operations expense for high cost loop support ("HCLS"), interstate common line support ("ICLS"), and local switching support ("LSS").

- The Commission should eliminate support where a competitor provides unsubsidized service and reject the rural LECs unreasonable standard (service to 95% of customers) for classifying another provider as "competitive."

- The Commission should reduce CAF subsidies where carriers provide local services at rates below a specified rate benchmark.

- The Commission should impose a budget on USF and CAF pegged to the actual costs of providing service to high cost areas.

- The Commission should reject calls for revenue neutrality because it produces customer rates that are unjust and unreasonable.

Finally, the self-serving nature of the ABC Plan filed by the largest wireline carriers is exemplified by its gratuitous demand that the Commission de-regulate incumbent carriers in order to "eliminate legacy regulations that act as a barrier to the transition to IP broadband networks*."* The NPRM did not request comment on the incumbent carriers' broader de-regulatory agenda nor does the record in this proceeding support the de-regulation they request. Implicit in the carriers' demand is an assumption that their mere migration to IP network protocols—an otherwise routine modernization of their network plant—can somehow justify de-regulation without regard to whether telecommunications markets are still non-competitive after the migration.

The Commission should reject the ABC Plan's call for sweeping deregulation under the guise of USF and ICC reform.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109

Comments

The Ad Hoc Telecommunications Users Committee ("Ad Hoc") hereby submits its Comments in response to the Commission's August 24, 2011 public notice regarding the reform proposal filed by the largest wireline carriers as the "ABC Plan" and those filed by smaller wireline carriers and state parties.[1]

[1] *Further Inquiry into Certain Issues in the Universal Service-Intercarrier Compensation Transformation Proceeding*, Public Notice, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, DA 11-1348 (rel. Aug. 3, 2011) (the "Public Notice").

I. THE COMMISSION SHOULD NOT ABANDON MEANINGFUL REFORM IN FAVOR OF INCREMENTAL INDUSTRY-SPONSORED PROPOSALS.

A. Ad Hoc Supports the Comprehensive Reform Proposed by the Commission in the NPRM.

Earlier this year, the Commission released a notice of proposed rulemaking ("the NPRM") proposing long overdue reform of the Universal Service Fund ("USF") program and the rules for inter-carrier compensation ("ICC").[2] The NPRM proposed a number of broad and forward-looking reforms to restructure the USF and revamp the ICC rules with an eye toward eliminating waste and inefficiency, allocating limited dollars to service areas that are truly high cost, and updating the system of inter-carrier payments to better reflect changes in network technology.

The need for comprehensive reform is well established. The high cost component of the USF ("High Cost Fund" or "HCF") has grown from $1.7 billion in 1998 to about $4.3 billion in 2010, and the interstate USF factor has soared from 3.2% in 1998 to 15.5% in the first quarter of 2011. Growth in the HCF and an ever-escalating interstate USF surcharge are unreasonably burdensome for end users, especially when many observers question the fund's utility for delivering service to high cost areas in a reasonably efficient manner as currently structured. Moreover, as telecommunications networks are transformed by IP-based technologies with cost characteristics different from the legacy TDM protocols on which the HCF and current inter-carrier compensation mechanisms are predicated, current funding methodologies,

---

[2] *Connect America Fund,* WC Docket No. 10-90, *A National Broadband Plan for Our Future,* GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers,* WC Docket No. 07-135, *High-Cost Universal Service Support,* WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime,* CC Docket No. 01-92*, Federal-State Joint Board on Universal Service*, CC Docket No. 96-45*, Lifeline and Link-Up,* WC Docket No. 03-109*,* Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 26 FCC Rcd 4554 (2011) ("NPRM")*.*

disbursement procedures, and ICC rules do not accomplish their historic goals or further the Commission's current goal of rapidly deploying broadband to underserved areas.

Ad Hoc supported many of the Commission's transformative proposals in the NPRM, having called for such fundamental reform in multiple pleadings with the Commission over the better part of the past decade. Despite the NPRM's failure to address reform for the USF contribution methodology, the Commission's current proceeding put reform efforts on the right track.

B. The Latest Wireline Industry Plans Promote Narrow Industry Objectives, Not the Public Interest.

In response to the Commission's broad reform efforts, carriers have developed alternative "reform proposals" (collectively, the "Carrier Plans") which are the subject of the Commission's Public Notice.[3] Not surprisingly, the Carrier Plans offer self-serving and incremental changes to the USF system and ICC rules. They protect the financial interests of industry participants but do not effectively or efficiently promote the Commission's public interest and broadband deployment goals. Most notably, they do not consider the interests of end users who bear the ultimate burden of funding universal service subsidies and ICC payments through the charges (and surcharges) they pay for telecommunications services.[4]

---

[3] Comments of the National Carrier Exchange Association, Inc., National Telecommunications Cooperative Association, Organization for the Promotion and Advancement of Small Telecommunications Companies; and Western Telecommunications Alliance, *Connect America Fund, et al,* WC Docket Nos. 10-90, 07-35, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51 (filed on April 18, 2011) (the "RLEC Plan"); Letter from Robert W. Quinn, Jr., AT&T, Steve Davis, CenturyLink, Michael T. Skrivan, FairPoint, Kathleen Q. Abernathy, Frontier, Kathleen Grillo, Verizon, and Michael D. Rhoda, Windstream, to Marlene H. Dortch, FCC, WC Docket No. 10-90 et al. (filed July 29, 2011) ("ABC Plan"). These Comments refer to the RLEC Plan and the ABC Plan collectively as the "Carrier Plans".

[4] Recently, a group of end users directly affected by USF and ICC reforms offered their own plan for USF and ICC reform measures. Letter from the Ad Hoc Telecommunications Users Committee, Google, Inc., Sprint Nextel Corporation, Skype Communications S.A.R.L., and Vonage Holdings Corp. to

Both the ABC Plan and RLEC Plan focus on preserving USF funding for traditional wireline services, directing onlylimited amounts to the use of alternative technologies such as wireless and satellite which are often more cost- effective for broadband deployments in high cost areas. Indeed, the Carrier Plans propose that nearly every dollar currently included in the HCF be reserved for price cap carriers and rate of return carriers.[5] By subsidizing, and thereby facilitating, incumbent carriers' continued control of last mile facilities, the Carrier Plans would impede the development of broadband competition for millions of Americans.

In addition, the Carrier Plans contain no competitive mechanisms, such as reverse auctions, that would target subsidies more cost-effectively and potentially reduce the overall size of the fund. Although the Carrier Plans pay some lip service to the notion that USF funds are not unlimited, neither plan proposes a cap on the USF budget or adoption of measures that would promote more efficient use of existing funding.[6] For example, the Joint Letter states that the parties responsible for the ABC Plan and RLEC Plan have "attempted to design their respective proposals to constrain the cost of the total high cost fund within a $4.5 billion per year budget."[7] But the Joint Letter does not propose that funding be capped at current levels, does not endorse the Commission's adoption of a strict budget cap at current disbursement amounts, does

---

Chairman Julius Genachowski, Commissioners Michael Copps, Robert McDowell, and Mignon Clyburn, WC Docket 10-90 et al. (filed Aug. 18, 2011). The Commission's assessment of the Carrier Plans should include an analysis of the proposals in the user plan.

5 Letter from Walter B. McCormick, Jr., United States Telecom Association, Robert W. Quinn, Jr., AT&T, Melissa Newman, CenturyLink, Michael T. Skrivan, FairPoint, Kathleen Q. Abernathy, Frontier, Kathleen Grillo, Verizon, Michael D. Rhoda, Windstream, Shirley Bloomfield, NTCA, John Rose, OPASTCO, and Kelly Worthington, WTA, to Chairman Julius Genachowski, Commissioner Michael J. Copps, Commissioner Robert M. McDowell, and Commissioner Mignon Clyburn, FCC, WC Docket No. 10-90 et al. (filed July 29, 2011) ("Joint Letter") at 2; ABC Plan, Attachment 1, at 1.

6 ABC Plan, Attachment 1, at 1. Joint Letter at 2. RLEC Plan at 89-93.

7 Joint Letter at 2.

not propose any mechanisms to constrain fund expenditures through more cost-effective or economically efficient disbursement policies, and forecloses opportunities for non-incumbent providers to receive funding. Similarly, the RLEC Plan questions whether current funding is sufficient to support broadband deployment[8] while simultaneously arguing against the use of competitive mechanisms such as reverse auctions that might produce a more economically efficient method for disbursing CAF dollars.[9]

Finally, the self-serving nature of the ABC Plan is exemplified by its gratuitous demand that the Commission de-regulate incumbent carriers in order to "eliminate legacy regulations that act as a barrier to the transition to IP broadband networks."[10] The NPRM did not request comment on the incumbent carriers' broader de-regulatory agenda nor does the record in this proceeding support the de-regulation they request. Implicit in the carriers' demand is an assumption that their mere migration to IP network protocols—an otherwise routine modernization of their network plant—can somehow justify de-regulation without regard to whether telecommunications markets are still non-competitive after the migration. As discussed in Section IX below, the Commission should reject the ABC Plan's call for sweeping deregulation under the guise of USF and ICC reform.

After delaying this rulemaking in anticipation of the industry reform proposals, the Commission must now redouble its efforts to adopt real and comprehensive USF/ICC reform consistent with the proposals in the NPRM.

---

8 RLEC Plan at 90.

9 *Id.* at 76-78.

10 ABC Plan, Attachment 1, at 13.

The Commission should not confuse the Carrier Plans with comprehensive reform of the type contemplated by the NPRM. The Carrier Plans simply entrench the *status quo* regarding current allocations of funding and unchecked growth in USF expenditures. Comprehensive reform requires that the most fundamental aspects of the USF programs and ICC rules be put on the table for consideration, as the NPRM approached these issues. Now is not the time for the Commission to go wobbly in its commitment to undertake the real reform of USF programs and ICC rules envisioned in the NPRM. The Commission must return this rulemaking to its original course by considering a broader scope of issues and proposals than those contained in the Carrier Plans.

Although industry participants have warned that any modifications to their carefully constructed plans will result in a withdrawal of their support,[11] the Commission has a statutory mandate to protect the public interest—not the interest of specific industry participants in preserving their subsidies—and ensure sufficient but not excessive funding for universal service programs. This overriding obligation may require the Commission to adopt regulations, modify policies, or withdraw subsidies that industry participants might not voluntarily propose but the Commission's role is to protect the public interest, not the financial expectations of carriers.

II. USF/CAF FUNDING SHOULD BE COMPETITIVELY NEUTRAL, TECHNOLOGY AGNOSTIC, AND SUPPORT ONE PROVIDER PER WIRE CENTER.

In its initial Comments on the NPRM, Ad Hoc supported the use of certain competitive mechanisms (like reverse auctions) identified by the Commission in the NPRM as useful and effective methods for encouraging broadband deployment to

11 Joint Letter at 1.

unserved and underserved areas in a competitively neutral, technology-agnostic manner. Rules that limit funding to a single provider in each wire center would provide the most economically efficient and rational use of limited USF and Connect America Fund ("CAF") funds. Ad Hoc urges the Commission to continue its support of a technology-neutral competitive bidding alternative and the mechanisms that support it by adopting the first of the two alternative CAF disbursement proposals detailed in the NPRM. Reverse auctions maximize the number of households that will have access to broadband with the added financial support of limited CAF dollars. By contrast, the Carrier Proposals limit the distribution of nearly all future CAF dollars to incumbent LECs for use with wireline-only broadband services. This approach is patently parochial, self-serving, and contrary to the public interest.

The Carrier Proposals do not include meaningful use of competitive mechanisms, such as reverse auctions, contemplated by the Commission in the NPRM. Instead, the Carrier Proposals dedicate CAF dollars for broadband deployment exclusively to incumbent LECs. As documented in the Declaration of Susan M. Gately, included as Appendix A to this filing, the ABC plan would allot $2.2 billion from the CAF for expenditure in areas presently served by incumbent price cap carriers. It would grant the incumbent price cap LECs a right of first refusal for $1.8 billion (82.2%) of those dollars—guaranteeing the price cap ILECs significantly more USF dollars in the future than the $1 billion they receive today.[12] While the current record demonstrates that substantial additional build-out is required for all customers in areas served by price cap ILECs to have broadband available at the speed and quality recommended in the

[12] Declaration of Susan M. Gately (the "Gately Declaration"), attached as Appendix A to these Comments, ¶ 16.

National Broadband Plan ("NBP"), there is insufficient information in the record to support allocation of CAF funding among any of the various classes of carriers: rural or non-rural, incumbent or competitor, wireline or wireless, price cap or rate of return.[13] Nothing in the current record supports setting aside $2.2 billion per year of the total CAF for the exclusive use of the price cap ILECs.

The Commission's should reject proposals that do not serve its goals in this proceeding – to reduce subsidy flows that do not further statutory goals and requirements for universal service and to allocate remaining funds in a manner that encourages carriers of *all kinds* to deploy the most economically efficient broadband connections to the largest number of unserved and underserved customers possible. By locking in technology and carrier choices, the Carrier Plans will necessarily result in less broadband deployment to fewer subscribers than a competitively designed disbursement program that permits all types of carriers to use a variety of technologies to serve high cost locations that remain unserved or underserved today.[14]

While the ABC Plan states that "providers can use any wireline or wireless technology that meets the specified bandwidth and service requirements,"[15] the Plan is heavily biased in favor of legacy wireline technologies. The Plan models network costs and distributes CAF dollars based upon the CostQuest Broadband Analysis Toll ("CQBAT") modeled costs of a wireline-only broadband network. Thus the wireline carriers that are awarded CAF funds under the ABC Plan will be free to use those funds for deployment of other, more efficient non-wireline broadband technology while end

---

[13] Gately Declaration ¶ 19.

[14] As documented in the Gately Declaration, record evidence suggests that wireless and satellite service may in fact be the most cost-effective method of deploying service for many locations. Yet the Carrier Plans would severely limit the broadband funds available for non-wireline technology solutions.

[15] ABC Plan, Attachment 1, at 3.

users funding the CAF through their purchases of telecommunications services will not be free to fund the cost of deployment based upon the actual (lower) cost of those more efficient non-wireline technologies. In short, under the ABC Plan, the benefits of delivering broadband over more efficient technologies are netted by the providers (and CAF subsidy recipients). The overall size of the CAF or subsidies claimed by the ILECs will not, however, shrink under this model.

The lack of any mechanism to return to the CAF over-estimates of broadband deployment costs to fund further deployments constitutes another serious flaw. As stated in the Gately Declaration:

> "[T]he proposed plan does not … include any mechanism that will keep the price cap LECs from simply flowing the differential between the CAF dollars granted on the basis of the wireline cost model and the [actual] cost of deploying a more cost-effective technology to any place but their shareholders and their bottom line."[16]

If the Commission reverses course and abandons the use of competitive mechanisms like reverse auctions to determine CAF disbursements, it must, at a minimum, structure disbursement of CAF funds such that awards for the first and subsequent years are made on the basis of the lower of the "modeled" costs of deploying service or the modeled costs of using the technology ultimately deployed. Any forward-looking economic cost ("FLEC") model used to establish potential disbursement levels for a particular high cost area must include wireless, satellite and any future technologies. Failure to include all available technologies for broadband will incent carriers to inflate the inputs to the cost model so that they can maximize the subsidies they receive from the CAF. Even worse, end users that ultimately fund USF and CAF subsidies through the surcharges they pay on their bills for

[16] Gately Declaration ¶ 24.

telecommunications services will overpay for the broadband deployment, inefficiently draining money from their businesses that could be used to fund other priorities, such as job creation. Households currently unserved or underserved will face delay (and even denial) in receiving the benefits of broadband deployment that the CAF is designed to deliver. The only beneficiaries of a plan that costs-out and distributes funds based upon the most expensive and least efficient technology choice, while allowing fund recipients to deploy a less expensive and more efficient technology choice, are the carriers.

Although Ad Hoc generally supports the concept of the ViaSat proposal referenced in the Public Notice to create a "Competitive Technology Fund" to deal with the "highest-cost areas,"[17] the Commission's goals would be better served by allowing all carriers and all providers to compete on an even footing for all CAF dollars, rather than having separate support mechanisms for wireline, wireless, satellite and other competitive technologies of the future.,.

III. THE COMMISSION SHOULD RELY ON AN APPROPRIATE FORWARD-LOOKING COST METHODOLOGY TO AWARD FUNDING FOR BOTH RATE OF RETURN AND PRICE CAPS CARRIERS.

In the Public Notice, the Commission asked whether funds distributed through the CAF should be awarded on the basis of competitive, technology-neutral bidding or whether funding should be offered to incumbent carriers first, with bidding used only in those instances where the incumbent carrier chooses not to undertake deployment based upon a CAF distribution amount generated by a forward looking cost model.[18] The Commission also asked whether it should revise its present rural non-rural

---

17 Public Notice at 8.
18 Public Notice at 3.

designations and instead distinguish between carriers for CAF purposes based upon the form of regulation applied to their operations.[19]

Once again, the Commission should stand by its proposal to use competitive bidding for CAF funds. Such an approach is the most competitive, market-based approach for disbursement of funds that best incents carrier recipients of CAF funds to deploy the most cost-effective technology to satisfy the Commission's broadband speed and quality specifications. Competitive bidding should apply and be open to all carriers, in all areas, whether they are classified as rural or non-rural, or regulated by price caps or rate of return. If the Commission walks away from its proposals to adopt competitive bidding mechanisms for determining disbursement of all CAF funds, the use of a FLEC model in conjunction with an incumbent carrier's right of first refusal would be far preferable to disbursing funds based upon the continuation of a rate of return or embedded cost model. As discussed in Section II, *supra*, however, the FLEC model must include the costs of deploying broadband over wireline, wireless, satellite or any other available technologies and cannot be limited to wireline-only deployment plans. Manipulating the funding metrics based upon the size of a carrier or the method used for regulating a carrier's other interstate services has no economic basis in determining the lowest costs for deploying broadband and will not maximize broadband deployment to unserved and underserved households.

---

[19] *Id.* It should be noted that the "set" of rural carriers and lines and the "set" of carriers and lines regulated under rate of return rules are virtually identical. The same is true of the "sets" of non-rural carriers and lines and carriers and lines regulated by price-caps. Based upon review of the data found at pages 4564 (Figure 2) and 4611(Figure 6) of the NPRM, more than 95% of existing HCF eligible carriers and lines would not be affected by a change in the rule to reference the method of regulation rather than the size of the carrier's serving area.

The Commission also seeks comment on the utility of the ABC Plan's CQBAT model for use as a FLEC model for CAF distribution purposes.[20] The Commission has not provided the public adequate time to review and comment on the CQBAT model. The first public glimpse of the ABC Plan was less than a month from the due date of this filing, and the back-up documentation to the CQBAT model necessary to provide reasoned comment on its utility was made available less than two weeks ago.[21] To make matters worse, the initial documentation for the CQBAT model was filed as "confidential" when it should have been filed, un-redacted, in the public record.[22] It is highly unlikely that, given this series of filing "errors," any party has had an opportunity to review the CQBAT model or its inputs adequately; certainly Ad Hoc has not. The Commission should not abet this inadequate public notice and opportunity to comment by rushing to judgment on the CQBAT model or requiring others to rush to such judgment. Given the importance of the model to the Commission's consideration of the ABC Plan and the large sums of CAF funding, as well as national priorities with respect to broadband deployment, that are at stake, the Commission should permit a reasonable period of time for review and comment on the underlying data of the CQBAT model.

The CQBAT model *may* offer a reasonable framework for a broadband FLEC model, and it *may* be that additional components can be developed for that model to generate FLEC results for other wireline and non-wireline technologies. Those

[20] Public Notice at 3.

[21] The ABC Plan authors first filed back-up data, marked confidential, on August 12, 2011, 12 days after the filing of the initial plan and 9 days following the release of the Public Notice which imposed an already abbreviated three week comment cycle. This initial data filing was missing 162 pages of the 165 pages provided to the Commission.

[22] An "erratum" was filed on August 18, 2011 just 4 business days before the close of the Comment cycle for the Public Notice and included the 162 pages that were "missing" from the initial filing.

components, however, do not exist at this time (or, if they do, they have not been revealed to the public). The Commission has not yet determined whether a model will be used to determine CAF disbursements. If the Commission decides to abandon its proposals to implement competitive mechanisms, like reverse auctions, in favor of using a FLEC model, it can evaluate (or seek comment on) the inputs to the CQBAT or other FLEC model at that time. As the development of the High Cost Model currently used for determining HCF disbursements illustrated many years ago, determination of the appropriate cost inputs to a FLEC model will, indeed, be as important as the construct of the model itself. The Commission should not put the cart before the horse by imposing inadequate time frames for analysis of data for a model it has not even decided to implement.

IV. THE FCC SHOULD ADOPT MEANINGFUL REFORMS FOR RATE OF RETURN CARRIERS THAT ELIMINATE ECONOMIC WASTE AND DISTORTION.

The compromise reform proposals submitted by the rate of return carriers offer only incremental changes to a badly broken system that needs comprehensive reform. Ad Hoc urges the Commission to reject the rate of return carriers' proposals and instead adopt the measures originally proposed in the NPRM.

A. The Commission Should Adopt an 8.5 Per Cent Interim Rate of Return, Subject to a Rebuttable Presumption for Carriers that Can Demonstrate Need for a Higher Figure.

In the Public Notice, the Commission requests information regarding the data needed in the record to waive the requirements of Part 65 of the Commission's rules to "quickly adopt a particular rate of return."[23] The current record may or may not contain information adequate to adopt a specific rate of return based upon actual earnings requirements of the rate of return carriers. Given the Commission's desire to move forward quickly with reform of the USF and implementation of the CAF without undertaking a comprehensive analysis of the appropriate rate of return, the Commission should adopt, as discussed below, only a presumptive rate of return with an opportunity for carriers to rebut the presumptive rate if they believe they are entitled to a higher rate based on their actual risk and operating constraints. To discourage frivolous challenges to the presumptive rate, the rules should provide that the Commission will impose a rate lower than the presumptive rate if the evidence proffered by the carrier demonstrates that a reduced rate is justified.

As a reasonable presumptive rate of return, Ad Hoc urges the Commission to adopt the 8.5% rate of return recommended by the State Members. In its initial comments, Ad Hoc discussed in greater detail why current rates for borrowing and other relevant metrics support a presumptive rate of return significantly lower than the current prescribed rate of 11.25%. In light of those factors, an 8.5% presumed rate would be more than adequate to support the earnings requirements of any rate of return carriers.

Under a presumptive approach, a carrier who believes that the 8.5% rate of return is insufficient may rebut the presumed rate by presenting to the Commission persuasive evidence of unique financial circumstances that justify a different rate of return. Any carrier that successfully rebuts the presumptive rate will be able to use its alternative rate to determine its interstate rate levels and to qualify for federal support dollars. Carriers that fail to rebut the presumptive rate would be subject to recovery at

[23] Public Notice at 6.

the actual rate of return to which its unique circumstances entitle it even if, based on the carrier's showing, that rate would be lower than the presumptive 8.25%. Such a mechanism will ensure carriers seeking recovery above the presumptive rate of rate have proper incentives in bringing their rate of return cases, and have done appropriate due diligence prior to using Commission resources to analyze such cases.

Finally, the Commission should consider the presumed rate of return to be a temporary measure until such time as the Commission undertakes a comprehensive review of rate of return carriers' actual earnings needs. Relying on a presumptive approach in the interim will enable the Commission to establish the CAF and begin allocating funds for broadband deployment immediately. But it will require the Commission to, at some point in the near future, evaluate its presumption of 8.5% against actual data to ensure that USF dollars are being allocated in a manner that is sufficient but not excessive, as required by the goals of universal broadband deployment.

B. The Commission Implement its Proposal to Eliminate Support for Corporate Operations Expense.

The Public Notice seeks comment on the application of new formulae for recovery of corporate operations expenses for high cost loop support ("HCLS"), interstate common line support ("ICLS"), and local switching support ("LSS").[24] Re-engineering current methods of support for corporate operations expense will undermine the Commission's twin goals of expanding universal broadband availability while minimizing the burden on consumers and businesses that support universal service. The Commission should, instead, adopt its own proposal to eliminate eligibility

---

[24] *Id.*

for recovery of corporate operations expenses through HCLS, LSS, and ICLS.[25] Adoption of new formulae and mechanisms like those identified in the Public Notice will simply perpetuate the inefficient and unnecessary subsidization of expenses that, inherently, are not high cost.

In its initial comments filed in this proceeding, Ad Hoc laid out the numerous studies and data supporting elimination of subsidies for recovery of these costs and explained how subsidization of these expenses has totaled over $1 billion (for HCLS disbursements alone) in the last decade.[26] Ad Hoc also noted that the Commission's prior efforts to cap disbursements for corporate operations expenses (with respect to HCLS) have proven ineffective over the long term, largely due to subsequent adjustments to the caps that were originally adopted.[27] The record does not provide any indication that recipients have curtailed inefficiency or waste in their corporate operations expenses as a result of HCLS caps, and the Commission should not now believe that tinkering with the formula for support of corporate operations expense or extending caps to ICLS and LSS will yield a different result this time around.[28]

The Commission has already concluded that corporate operations expenses are not related to the unique high cost characteristics that rural carriers face in providing service but rather result from "managerial priorities and discretionary spending."[29] The Rural Associations interested in protecting the HCF subsidy stream to support their

---

25 NPRM, 26 FCC Rcd at 4624, ¶ 198.

26 Comments of the Ad Hoc Telecommunications Users Committee, *Connect America Fund, et al,* WC Docket Nos. 10-90, 07-35, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, (filed Apr. 18, 2011) ("Ad Hoc Comments").

27 *Id.* at 19 n.47.

28 *See, e.g.,* RLEC Plan at 11 (proposing to cap corporate operations expense for ICLS and LSS in the same manner as such caps were imposed for HCLS, characterizing such an approach as "more reasonable" than the Commission's proposal to eliminate subsidization of such expenses).

29 NPRM, 26 FCC Rcd at 4623, ¶ 197.

members' corporate operations expenses muster no convincing argument or evidence to dispute this conclusion other than to disagree with it and state that such expenses are "related and essential to the provision of sustainable, high-quality, and affordable services in rural areas".[30] If that is true and such expenses are merely related to the provision of service (as they are for all carriers) but not related to the high cost characteristics of providing such service (as the Commission has already concluded), then subsidizing these expenses through the HCF when they are not inherently high cost is logically and financially unjustifiable.

As Ad Hoc stated in its initial comments, the Commission should not delay adoption of its proposal to eliminate subsidies for corporate overhead,[31] nor should the Commission be persuaded to implement the incremental reforms proposed in the Public Notice, which may modestly reduce support for corporate overhead but not eliminate it. Current estimates for the cost of subsidizing corporate overhead expenses run as high as half a billion dollars.[32] By eliminating this unnecessary and ineffective subsidy, the Commission can achieve meaningful savings immediately that can be reallocated to fund the pressing national priority to expand broadband deployment.

C. The Commission Should Eliminate Support Where a Competitor Provides Unsubsidized Service and Reject the RLECs' Exclusionary Model.

The Commission has requested comment on the RLEC Plan's proposal to establish a high threshold for (effectively, a presumption against) elimination of

---

30 RLEC Plan at 40. The RLECs observe that corporate operations expenses "include costs associated with various accounting and finance functions, managing vendors, and regulatory compliance efforts" but make no effort to claim that such expenses are greater because of the increased costs associated with providing service in legitimately high cost areas. *Id.* at 11 & n.12.

31 Ad Hoc Comments at 22.

32 *Id.*

incumbent subsidy support in so-called “competitive” areas. As a general matter, Ad Hoc strongly supports the elimination of USF (and, eventually, CAF) support to incumbents providing service in areas that are also served by an unsubsidized competitor.[33] The continued subsidization of incumbent providers—much like the subsidization of multiple providers in a single area—makes little economic sense when a competing provider can and does provide service without subsidies.

The Commission should not adopt the RLEC Plan’s approach for several reasons. First, it imposes an exclusionary threshold for determining the “competitiveness” of a service area by requiring that nearly every household in a service area be served by a competitor before the incumbent risks loss of its subsidy. By requiring an unsubsidized competitor to serve 95% of households in a service area,[34] the RLEC Plan effectively guarantees that incumbents will continue to receive subsidies even when a huge percentage of households in its service area receive or could receive service from an unsubsidized competitor. The Commission should not adopt a threshold that unsubsidized competitors cannot reasonably meet because it will needlessly prolong incumbent subsidy support which, in turn, removes incentives for the incumbent to deploy lower cost, more efficient facilities to deliver service. By creating a revenue stream that is unlikely to be threatened by real competition, the Commission will not reduce demand on limited USF dollars.

Second, the RLEC Plan inexplicably imposes the burden on the unsubsidized competitor (the market participant) to prove with “clear and convincing evidence” that

[33] *Id.* at 38.
[34] RLEC Plan at 52.

the incumbent (the subsidized recipient) is no longer entitled to a subsidy.[35] This incentive structure is completely backwards. An economically rational approach would require that the subsidy recipient bear the burden of proving that (1) it is entitled to continued subsidization in what is, after all, a *prima facie* competitive market, and (2) its competitors in the market do not serve the requisite percentage of households. The percentage threshold should be established by the Commission based on actual data, which only then would trigger elimination of continued incumbent subsidy support.

Third, the RLEC Plan fails to address the role that competitive mechanisms, like reverse auctions, could play in determining competitors' willingness to serve all or parts of a study area (however drawn) at a lower subsidy level than the incumbent currently receives.[36] By moving to a cost-based subsidy model, where costs are supported by actual data submitted by providers or through competitive mechanisms, the Commission can more effectively match fund dollars with the actual costs of providing service to high cost areas.

The RLEC Plan's arbitrary threshold and reverse presumption are clearly focused on one goal: preservation of incumbent subsidy support. The Commission, however, must adopt a policy that serves a broader public interest which, in this particular case, requires allocation of limited USF and CAF dollars to providers that can deliver broadband and quality voice service in the most cost-effective way. To that end, the Commission should not eliminate from its consideration mechanisms that would reduce incumbent subsidy support in each instance where a competitor can provide equivalent service at a lower cost. Furthermore, it should impose the burden of

---

[35] *Id.*
[36] NPRM, 26 FCC Rcd at 4681-82, ¶418.

justifying eligibility for continued receipt of subsidies on the recipient of such subsidies who controls the data required for the Commission's analysis; it should not transfer that burden to non-subsidized competitors as proposed in the RLEC Plan.

V. EMBEDDED COST MODELS CREATE ECONOMIC DISTORTIONS THAT POORLY PROTECT CONSUMER INTERESTS AND INEFFICIENTLY ALLOCATE USF/CAF DISBURSEMENTS.

A. The Commission Should Reduce CAF Subsidies for Carriers that Provide Local Services at Rates Below a Specified Rate Benchmark.

The Public Notice requests comment on Ad Hoc's proposal in this proceeding that the Commission adopt a "low price offset" as part of "near-term" reforms to make some portion of the present HCF funds available for the new CAF.[37] Under Ad Hoc's proposal, the Commission would make a "low price offset" to a carrier's current USF disbursements if its local service prices fall below a relevant benchmark. The Public Notice requests comments on what the relevant benchmark rate might be, whether the benchmark should ratchet up over time, and whether the same benchmark should be used for ICC purposes.

As discussed in more detail in the Gately Declaration, the "benchmark" used to calculate the offset could reasonably fall anywhere between: (i) the weighted nationwide average monthly charge (including fees) found in the FCC's Reference Book of Rates ("RBR"); and (ii) the highest monthly charge (including fees) being charged by other ILECs in the state for comparable service reported in the RBR. Instead of increasing the benchmark over fixed periods of time, or increasing or decreasing the offset in response to changes a LEC may make to its local service rates following implementation of the offset plan, Ad Hoc proposes that the Commission base the

[37] Public Notice at 7; Ad Hoc Comments at 29–31.

calculation on the differential between: (i) the prices being charged by the local carriers today; and (ii) the benchmark. The differential will be carried forward for the five year period over which many of the other "Near Term Reforms" are being implemented and used to offset the CAF disbursements provided to the carrier.

The local service rate benchmark used for a "low price offset" should not be the same benchmark used for ICC purposes (nor for any revenue-based mechanism that might be implemented as part of the CAF distribution system). With the exception of this limited benchmark that has been proposed as a "near term" reform to free up CAF dollars, any other analysis of prices or revenues must include not only basic local service but the other (including non-regulated) services sold in conjunction with the access line or customer account being subsidized.

B. Review of Total Company Earnings is Unnecessary if the Commission Adopts the NPRM's Competitive Bidding Models for CAF Disbursements.

The Public Notice asks a number of questions related to review of carrier earnings.[38] The Commission's focus on the difficulties inherent in evaluating total company earnings in this context underscores, once again, the need for the Commission to move away from use of embedded costs or rate of return based distribution mechanisms for allocation of CAF funds and instead utilize a competitive bidding and/or FLEC based model for such disbursements.[39] Use of such an alternate funding mechanism will make the problem identified in the Public Notice far less serious

---

[38] Public Notice at 7-8.

[39] Ad Hoc has for many years supported the elimination of rate of return based regulation as it is used in the disbursement of HCF USF dollars and has, on prior occasions, cautioned the Commission against continuing discredited disbursement methodologies that encourage RLEC inefficiency. *See* Comments of the Ad Hoc Telecommunications Users Committee on the Petition for Rulemaking to Eliminate Rate-Of-Return Regulation of Incumbent Local Exchange Carriers by Western Wireless Corporation, CC Docket 96-45, RM-10822 (filed Jan. 16, 2004) at 9.

over time. As with the Commission's inquiries into the CQBAT model, the Commission should determine whether it will adopt a distribution framework that relies upon such data before it invests time and resources identifying the data needed to evaluate ILEC total company earnings levels.. While a record is developed on the issue of total company earnings, the Commission should set as its goal identifying and developing a plan of action for obvious over earning situations.

As the Commission itself observed nearly fifteen years ago regarding use of the embedded cost standard, "[c]urrent support mechanisms neither ensure that ILECs are operating efficiently nor encourage them to do so" and "effectively discourage efficiency."[40] In addition, the Commission has noted that "[c]alculating high cost support based on embedded cost is contrary to sound economic policy."[41]

No party can realistically assume that the Commission can audit and conduct rate cases on 1400 carriers. In this case, it would be a terrible mistake to allow the perfect to become the enemy of the good. The Commission should limit its inquiry to those carriers showing substantial over-earnings[42] and target its revenue analysis at the most serious problems first.

VI. THE COMMISSION SHOULD IMPOSE A BUDGET ON USF AND CAF PEGGED TO THE ACTUAL COSTS OF PROVIDING SERVICE TO HIGH COST AREAS.

In response to the Public Notice's request for comment on methods for implementing reform within a defined funding budget, Ad Hoc reiterates its support for the adoption of a defined budget and traditional budget controls to improve the

---

[40] *Universal Service First Report and Order* at 8935.

[41] *Id.*

[42] For example, the highest of the earners – Windstream's operating company serving Lexington, Kentucky – reported earnings of 99% in 2008, the same year it received $4.9 million in IAS funds (and $3.6 million in HCM funds). Ad Hoc Comments at 34 & n.91.

efficiency and effectiveness of the USF and CAF.[43] The Commission must establish a fixed annual funding budget and allocate funds as necessary to ensure that disbursements do not exceed the budget cap. The initial budget for the CAF and residual USF support should be no greater than the current amount of the HCF.

Going forward, the Commission should adopt targeted reductions to the overall CAF budget. To achieve these reductions, the Commission should undertake measures that will eliminate support for carriers that do not need subsidies to provide service to high cost areas. The Commission should also adopt the proposals in the NPRM to eliminate wasteful and unnecessary components of the existing HCF, such as subsidies for corporate operations expenses, local switching support, disbursements under the identical support rule, and reassessment of the (inflated) 11.25% rate of return (if a lower presumptive rate or return, as proposed above, is not adopted).

In response to the Commission's request for specific proposals to maintain funding within a budget,[44] Ad Hoc supports measures that will, in the short term, limit fund disbursements to current levels and, over time, reduce disbursements from the fund by better matching the actual costs of delivering service to high cost areas with fund subsidies. The current rules encourage providers to incur and/or report higher costs to obtain higher subsidies, but the Commission does not assess the accuracy or suitability of reported costs. Furthermore, deferring reductions in inter-carrier compensation in order to preserve existing USF funding levels is misguided. Keeping carriers artificially "whole" through the inter-carrier compensation rules when USF reforms result in reduced funding is economically wasteful and needlessly jeopardizes

[43] Ad Hoc Comments at 39-42.
[44] Public Notice at 9.

the Commission's efforts to rationalize USF support/broadband deployment and inter-carrier compensation.

The recent dramatic growth of the USF (with only modest and incremental increases in subscribership rates) indicates that fund dollars have not been disbursed or invested efficiently. Beneficiaries of the current system appear unwilling to accept the serious reforms proposed by the Commission. The RLEC Plan, for example, opposes adoption of a cap on USF/CAF disbursement, speculating that "high cost support at current levels will not provide sufficient funding to accomplish the nation's broadband goals."[45]

The Commission should not accept this proposition without a careful examination of cost data and/or implementation of competitive funding mechanisms. We urge the Commission to right the ship rather than perpetuate existing practices that have led to the unsustainable growth of the fund.

VII. ICC REFORM PREMISED ON REVENUE NEUTRALITY WILL PRODUCE RATES THAT ARE UNJUST AND UNREASONABLE.

There is no economic or policy basis for locking in revenues currently provided under an ICC funding mechanism that is broken.[46] Those portions of the ABC Plan and the Joint Letter proposal that advocate preservation of existing revenue streams via increased SLCs, higher local service prices, and offsetting payments from the CAF or other USF elements should be rejected. The Commission would be imposing unjust and unreasonable rates if it were to establish new or increased rate elements in the

[45] RLEC Plan at 90.
[46] The Public Notice solicits comments on the "recovery mechanisms" proposed as part of both of the ILEC ICC plans. Public Notice at 13.

name of “revenue neutrality” for carriers who already have an adequate opportunity to recover their costs plus a reasonable profit, even after ICC charges are reduced or eliminated, from the revenues they receive for regulated and non-regulated services provided over their networks.

Neither Ad Hoc’s views nor the facts of the matter have changed since it filed its initial comments in this proceeding in April.[47] At that time, Ad Hoc stated that:

> Carriers are not entitled to rate increases merely because they’ve grown accustomed to an artificially inflated intercarrier compensation revenue stream under the existing regime and wish to preserve it.[48]
>
> Guaranteeing revenue neutrality regardless of a carrier’s underlying costs, or with no examination of those costs to determine whether a carrier is profitable even with reduced ICC revenues, cannot be justified by any overriding goal of “mak[ing] affordable broadband available to all Americans” because there is no assurance that any such guaranteed revenues will be used for broadband investment. [footnote omitted].[49]

and, that:

> Instead of guaranteeing revenue neutrality as part of ICC reform, the Commission should establish a rebuttable presumption that carriers do not need to raise other rates when ICC charges are reduced or eliminated.[50]

However, to the extent that the Commission goes down the regrettable path of allowing a revenue recovery mechanism, the recovery must include a step-down plan and there should be no distinction between price cap ILECs and rate of return ILECs.

VIII. INTERCARRIER COMPENSATION REDUCTIONS WILL PRODUCE CONSUMER AND ECONOMY-WIDE BENEFITS.

The Public Notice requests comments on the consumer impact of intercarrier compensation reform, including both the indirect effects of reducing carrier-to-carrier per

---

47 Ad Hoc Comments at 49 – 64.
48 *Id.* at 49.
49 *Id.*
50 *Id.* at 50.

minute payments to a cost-based level (near zero) and the direct effects of allowing the ILECs to increase subscriber line charges ("SLCs").[51] Proponents of the ABC Plan supported the plan with a paper by Dr. Jerry Hausman that analyzes and attempts to quantity the indirect consumer benefits of reduced carrier-to-carrier payments. But the paper is fundamentally flawed because it ignores any countervailing impacts from increased SLCs.[52]

Ad Hoc asked its economic consultant, Susan Gately, to review the Hausman study's estimate of approximately $9 billion in annual consumer welfare. The Gately Declaration reveals that, while the Hausman analysis does have some flaws (most importantly the failure to net out of the consumer welfare analysis any countervailing negative impacts from the proposed SLC increases that are integral to the ABC Plan), its overall approach and the conclusion that consumers and the economy as a whole will benefit from putting an end to overpriced intercarrier compensation pricing appear sound.[53] Notably, the Hausman analysis is remarkably similar to a 2007 study[54] the Ad Hoc committee submitted in the pending special access investigation which quantified the economy-wide benefits of ending the overpricing of special access services.[55]

As to the Public Notice queries on the proposals to increase subscriber line charges, Ad Hoc refers the Commission to the detailed discussion of this issue in Ad

---

[51] Public Notice at 16-17.

[52] ABC Plan, Attachment 4. It should be noted that if, as Ad Hoc has proposed, the Commission declines to allow the ILECs to automatically make up any revenue losses that may occur as a result of decreased ICC rates then the Hausman analysis can be viewed as complete.

[53] Gately Declaration ¶¶ 3 – 14. This includes the assumption that the competitive market for long distance services will eventually pass through most, if not all, of the reductions in intercarrier costs.

[54] Lee L. Selwyn, Susan M. Gately, Helen E. Golding and Colin B. Weir, Special Access Overpricing And the Us Economy: How Unchecked RBOC Market Power is Costing US Jobs and Impairing US Competitiveness, Economics and Technology, Inc., August 2007 (Special Access Study), included as Appendix 1 to the Comments of the Ad Hoc Telecommunications Users Committee in *Special Access Rates for Price Cap Local Exchange Carriers*, CC Docket No. 05-25 (filed Aug. 8, 2007).

[55] Gately Declaration ¶¶ 3 – 7.

Hoc's Comments, which observed that proposals to increase SLCs as a revenue neutrality mechanism are inherently inconsistent with the design and operation of SLCs and should be abandoned.[56] Any revenue recovery permitted as an offset to reduced intercarrier compensation should not occur without a demonstration of need based upon a carrier's actual operations.

IX. THE COMMISSION SHOULD REJECT CLAIMS THAT USF REFORM JUSTIFIES DE-REGULATION FOR PRICE CAPS CARRIERS.

With no accompanying rationale or justification, the ABC Plan proposes that the Commission eliminate "legacy regulations" from price cap carriers that "act as a barrier to the transition to IP broadband networks."[57] This call for broad deregulation has nothing to do with reform of USF programs or ICC rules and would have no impact on the deployment of broadband technologies. Moreover, none of the potential reforms under consideration by the Commission in this proceeding would affect the underlying competitiveness of regulated markets.

While it is true that next generation IP-based networks exhibit cost characteristics that are different from the TDM networks upon which current USF programs and ICC rules are based, comprehensive reformation of USF and ICC does not require broad deregulation of markets that are not competitive. The price cap carriers' proposal simply uses the current proceeding as yet another occasion to demand deregulation in markets where they maintain bottleneck control. There is no necessary relationship between the "hundreds of billions of dollars of private investment" supposedly necessary to transition from TDM to IP-based networks and the "non-regulation of

---

[56] Ad Hoc Comments at 56 – 62.
[57] ABC Plan, Attachment 1, at 13.

broadband and other information services." Any broad deregulation of such markets must be undertaken pursuant to a separate proceeding that collects actual data to determine whether such markets are sufficiently competitive, based on facts in a record, to warrant such vast deregulation.

CONCLUSION

The Ad Hoc Telecommunications Users Committee urges the Commission to reject the Carrier Proposals for USF/ICC reform and implement instead the reform proposals described in the NPRM for this proceeding.

Respectfully submitted,

AD HOC TELECOMMUNICATIONS
USERS COMMITTEE

Colleen Boothby

Susan M. Gately
SMGately Consulting, LLC
84 Littles Ave,
Pembroke, MA 02359
(617) 598-2223

Economic Consultant

Colleen Boothby
Andrew M. Brown
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, NW, Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for Ad Hoc Telecommunications
Users Committee

August 24, 2011

Certificate of Service

I, Amanda Delgado, hereby certify that true and correct copies of the preceding Comments of Ad Hoc Telecommunications Users Committee were filed this 24th day of August, 2011 via the FCC's ECFS system and by email to:

Best Copy and Printing, Inc. (BCPI)
fcc@bcpiweb.com

Amanda Delgado
Legal Assistant
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, NW
Suite 900
Washington, DC 20036